NO. 82-1565

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

BACCHUS IMPORTS, LTD., et al.,
Appellants,

vs.

GEORGE FREITAS,
Director of Taxation of the State of Hawaii, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE
STATE OF HAWAII

BRIEF FOR APPELLEE IN SUPPORT OF APPELLANTS

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SPIRITS CO.

September 1, 1983

QUESTIONS PRESENTED

1. Does a state tax of 20% ad valorem on the sale at the wholesale level of all liquor sold in Hawaii, which exempts certain locally produced liquors for the express purpose of fostering and protecting local industries, discriminate against imported liquors and constitute an undue burden on interstate and foreign commerce in violation of the Commerce Clause of the United States Constitution?

2. Does such a discriminatory state tax by taxing imports based on their place of origin constitute an impost or duty on imports prohibited by the Import-Export Clause of the United States Constitution?

3. Does such a discriminatory state tax, by exempting certain locally made liquors while taxing liquors imported from foreign and out-of-state sources by certain wholesalers, deny them the equal protection of the laws?

PARTIES TO THE PROCEEDINGS BELOW

The parties to the proceeding in the Supreme Court of Hawaii, Case No.7802, October Term 1979, were Bacchus Imports, Ltd., Eagle Distributors, Inc., Paradise Beverages, Inc. and Foremost-McKesson, Inc., dba McKesson Wine & Spirits Co., as Petitioners, and George Freitas, Director of Taxation of the State of Hawaii, as Respondent.

STATEMENT OF CORPORATE RELATIONSHIPS

Pursuant to Supreme Court Rule 28.1, Foremost-McKesson, Inc.,* doing business as McKesson Wine & Spirits Co., submits the following list naming all of its parent com-

*Foremost-McKesson, Inc., changed its name to McKesson Corporation effective July 27, 1983. It continues to do business under the trade name McKesson Wine & Spirits Co.

panies, subsidiaries (except wholly owned subsidiaries) and affiliates:

City Properties, S.A.; Corporacion Bonima, S.A.; Intercal, Inc.; Mount Gay Distilleries, Ltd.; Organizacion Farmaceutica Americana, S.A.; Foremost-Baldwin Partners; Foremost Genetics Associates; Influential Homes Co.; Visitacion Associates; Foremost Dairies Company (Bangkok) Ltd.; Formac Trading (Taiwan) Ltd.; Taiwan Merchant Supply Co., Ltd.; Crockers Homes, A Joint Venture; Ditz-Crane Associates; Ditz-Crane of Arizona, A Joint Venture; Foremost Hawaiiana; Foremost H.P.I.; Foremost-McCormack Development; Jackson Albany Association; Norwalk Santa Fe Springs Associates; La Vascongada, S.A.C. e I.; Foremost Dairies (Taiwan) Ltd.; Calox Panamena, S.A.; Distribuidora Farmaceutica Calox Colombiana, S.A.; Foremost Dairies (Nigeria) Ltd.; Jamjoom-Foremost, Ltd.; Laboratories Calox, C.A.; Lebanese Foremost Dairies S.A.L.; Nosi Sales Corporation; and National Optical Services, Inc.

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OPINIONS BELOW

The opinion of the Supreme Court of the State of Hawaii is reported in *Matter of Bacchus Imports, Ltd.*, 65 Hawaii ______ , 656 P.2d 724 (1982).

JURISDICTION

The judgment of the Supreme Court of the State of Hawaii, which sustained the validity of the Hawaii liquor tax statute, was entered on January 5, 1983. The notice of appeal was filed by appellants with the Hawaii Supreme Court on March 3, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1256(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

Article I, Section 8, Clause 3 of the United States Constitution provides in part: "The Congress shall have power . . . [t]o regulate Commerce with foreign nations, and among the several states. . . ." U.S. Const. art. I, § 8, cl. 3.

Article I, Section 10, Clause 2 of the United States Constitution provides in part: "No State shall, without the consent of Congress, lay any Imposts or Duties on Imports or Exports. . . . ." U.S. Const. art. I, § 10, cl. 2.

Section 1 of the Fourteenth Amendment provides in part: "No State shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1.

Section 244-4 of the Hawaii Revised Statutes, as amended to date, provides in part:

> Every person who sells or uses any liquor not taxable under this chapter in respect of the transaction by which such person or his vendor acquired such liquor, shall pay an excise tax which is hereby imposed, equal to twenty per cent of the wholesale price of the liquor so sold or used; provided, that the tax shall be paid only once upon the same liquor; provided, further, that the tax shall not apply to:
>
> . . .
>
> (6) Okolehao manufactured in the State for the period May 17, 1971, to June 30, 1981; or

(7) Any fruit wine manufactured in the State from products grown in the State for the period May 17, 1976 to June 30, 1981; or

(8) Rum manufactured in the State for the period May 17, 1981 to June 30, 1986.

STATEMENT OF THE CASE

Foremost-McKesson, Inc. (McKesson) is a Maryland corporation registered to do business in the State of Hawaii, and doing business as McKesson Wine & Spirits Co., a division of Foremost-McKesson, Inc. (Joint Appendix [hereinafter "J.A."] 18). It is licensed by the liquor commission for each county of the State of Hawaii as a liquor wholesaler pursuant to Hawaii Revised Statutes § 281-31 (Supp. 1982) and by the Department of Taxation for the State of Hawaii as a permittee pursuant to Hawaii Revised Statutes § 244-2 (Repl. 1976). (J.A. 18). Appellee George Freitas is the Director of Taxation of the State of Hawaii and, in such capacity, is charged with administering the Hawaii liquor tax for the State of Hawaii. (J.A. 18). *See generally* Hawaii Rev. Stat. §§ 244-1 *et seq.* (Repl. 1976).

McKesson imports foreign and domestic liquor into the State of Hawaii, warehouses such liquor on premises licensed by agencies of both the United States and the State of Hawaii, and sells such liquor at wholesale. (J.A. 19). Foreign-produced liquors are either shipped directly to Honolulu, Hawaii, or indirectly through other states. (J.A. 19-21). Domestic liquors are shipped from the other states. (J.A. 21).

Section 244-4 of the Hawaii Revised Statutes imposes a tax on the first sale at wholesale of liquor, at a rate of 20% of the wholesale price (which includes freight charges, customs duties

and federal taxes, and the wholesaler's markup).[1] The tax is payable by the wholesaler whether or not it is collected from the purchaser, and is assessed on monthly gross sales reported to the state. (J.A. 22). McKesson generally sells liquor to businesses in Hawaii at a price equal to its wholesale price plus the 20% tax imposed by Section 244-4, plus the 0.5% general excise tax imposed by Hawaii Revised Statutes § 237-13 (Supp. 1982). (J.A. 22).

Since 1960, Hawaii's legislature has enacted various exemptions from the liquor tax designed to foster local liquor industries. From 1960 to 1965, okolehao (a brandy distilled from the roots of the ti plant) produced in Hawaii was exempted from the tax.[2] This exemption expired in 1965, but was reenacted in 1971,[3] and extended again in 1976.[4] It expired in 1981. By the same act in 1976, a five-year exemption from the liquor tax was also granted to wine made in Hawaii from fruit grown in the state.[5] This exemption also lapsed in 1981. However, in its 1981 session, while the present case was pending

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[1] Wholesale price for imported liquors is determined by adding a percentage markup to its "landed cost" for such liquor. Landed cost is determined by adding the following costs to the original cost (F.O.B.) of the liquor:

(1) United States Customs duties (foreign liquors);
(2) United States Internal Revenue Service gallonage taxes;
(3) Customs brokerage fees;
(4) Inland freight to port of shipment to Honolulu;
(5) Ocean (or air) freight to Honolulu (including currency adjustment fees added by the shipment company);
(6) Wharfage fees at Honolulu;
(7) Drayage charges for transportation to the warehouse;
(8) Warehouse handling charges.

(J.A. 21-22).

[2] 1960 Hawaii Sess. Laws, c. 26, § 1.

[3] 1971 Hawaii Sess. Laws, c. 62, § 1.

[4] 1976 Hawaii Sess. Laws, c. 39, § 1; Hawaii Rev. Stat. § 244-4(6) (Supp. 1982).

[5] 1976 Hawaii Sess. Laws, c. 39, § 1; Hawaii Rev. Stat. § 244-4(7) (Supp. 1982).

before the Hawaii Supreme Court, the legislature enacted a new exemption for "[r]um manufactured in the State for the period May 17, 1981 to June 30, 1986."[6]

The rate of the tax has been steadily increased over the years to the present rate of 20%. Originally, the tax was imposed at the rate of 6% of sales at retail or wholesale if the sale was directly to the consumer.[7] In 1947, the rate was raised to 8%.[8] Two years later, responsibility for payment of the tax was shifted from the retailers to the wholesalers, and the rate was increased from 8 to 12%.[9] In 1957, the rate was further increased to 16%.[10] Lastly, in 1965, the rate was raised to the current 20%.[11]

On September 6, 1979, McKesson protested the assessment of the liquor tax by a letter directed to the Department of Taxation. (J.A. 19).[12] Shortly thereafter, it filed suit seeking a refund of taxes paid since August, 1974. (J.A. 19). The complaint alleged, among other things, that the Hawaii liquor tax discriminated in favor of locally produced liquor in contravention of the Import-Export, Commerce and Equal Protection Clauses of the United States Constitution.

The case was consolidated with similar suits filed by Bacchus Imports, Ltd., Eagle Distributors, Inc., and Paradise Beverages, Inc. (hereinafter collectively referred to as "taxpayers"), and was heard on stipulated facts in the Hawaii Tax

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[6] 1981 Hawaii Sess. Laws, c. 182, § 1; Hawaii Rev. Stat. § 244-4(8) (Supp. 1982).

[7] 1939 Hawaii Sess. Laws, c. 222, § 5.

[8] 1947 Hawaii Sess. Laws, c. 111, § 14[b].

[9] 1949 Hawaii Sess. Laws, c. 343, § 3.

[10] 1957 Hawaii Special Sess. Laws, c. 1, § 7 [b].

[11] 1965 Hawaii Sess. Laws, c. 155, § 8.

[12] Payment of taxes under protest, and subsequent suit for their refund, is provided for in Hawaii Rev. Stat. § 40-35 (Supp. 1982). The taxes paid with the protest and all subsequent taxes paid during the pendency of this action were deposited into an escrow known as the "litigated claims fund." Depending upon the outcome of this appeal, the taxes in the fund will either be returned to the taxpayers or become a realization of the state.

Appeal Court. The court upheld the tax, ruling against the taxpayers' constitutional claims. The taxpayers then appealed to the Hawaii Supreme Court, which continued the consolidation effected by the Tax Appeal Court.

In its opinion and by single judgment against all of the taxpayers in the consolidated suit, the Hawaii Supreme Court rejected each of the constitutional challenges and sustained the validity of the tax. A timely appeal to this Court from the consolidated judgment was filed by Bacchus Imports, Ltd., and Eagle Distributors, Inc. McKesson and Paradise Beverages, Inc., did not file separate appeals, but are parties to the appeal pursuant to Rule 10.4 of the Supreme Court Rules.

SUMMARY OF ARGUMENT

The State of Hawaii imposes an excise tax on the first sale at wholesale of all liquor sold or used in the state. The tax rate is 20% of the wholesale price of the liquor so sold or used, and is payable monthly by the wholesaler. To promote the development and growth of the state's economy, Hawaii has granted five-year renewable exemptions from the tax to various local liquor industries. The exemptions confer a significant, albeit artificial, cost advantage on the favored local products versus out-of-state products subject to the tax.

A. *Commerce Clause*. By exempting locally manufactured products from the imposition of its liquor tax, Hawaii violates the Constitution. The exemptions provide a substantial and "direct commercial advantage to local business" in contravention of the Commerce Clause. *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 329 (1977). This Court has long held that the Commerce Clause does not permit a state to encourage the development of its local industry by means of taxing measures which, like the Hawaii tax, impose greater economic burdens on products produced outside the state than are imposed on similar products produced within the state. Indeed, such simple economic protectionism is subject to a "virtually per se rule of invalidity," *Philadelphia v. New*

Jersey, 437 U.S. 617, 624 (1978), since the "basic purpose" of the Commerce Clause is "to prohibit the multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution." *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981).

The lower court justified the discrimination against out-of-state products by finding that the "incidence of the tax is on wholesalers in Hawaii and the ultimate burden is borne by consumers in Hawaii." *Matter of Bacchus Imports, Ltd.*, 65 Hawaii ______ , 656 P.2d 724, 734 (1982). The fact that an otherwise discriminatory tax is imposed on a local event at the end of the interstate commerce has never been a defense to a Commerce Clause challenge. "[T]he commercial power [of the federal government] continues until the commodity has ceased to be the subject of discriminatory legislation by reason of its foreign character. That power protects it, even after it has entered the State, from any burdens imposed by reason of its foreign origin." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 332 n.12 (quoting *Welton v. Missouri*, 91 U.S. 275, 282 (1876)).

Nor can the liquor tax be justified by the lower court's assumption that the exempted liquor does not pose a "competitive threat" to liquor produced out-of-state. First, the lower court failed to realize that the test is not the extent of the discrimination, but whether discrimination exists. "We need not know how unequal the Tax is before concluding that it unconstitutionally discriminates." *Maryland v. Louisiana*, 451 U.S. at 760. Second, a dollar-and-cents comparison of the actual tax burden on liquors produced in-state and out-of-state shows that the Hawaii tax unconstitutionally discriminates against the latter. For example, given the pyramid effect of the tax, a case of California wine with a F.O.B. cost of $10.00 per bottle would incur a tax of $56.40 upon its sale in Hawaii. No tax would be assessed on a sale of like wine produced in Hawaii. Such an inequality of tax burden is plainly discriminatory within the meaning of this Court's Commerce Clause cases.

Finally, the lower court ignored several early decisions of

this Court, in particular, *Walling v. People of Michigan*, 116 U.S. 446 (1886), which clearly established that no state may, consistent with the Commerce Clause, discriminatorily tax the products of other states or persons engaged in the sale of such products. In view of these precedents, it may be said of the Hawaii tax, as it was of the tax at issue in *Walling*, "[i]f this is not a discriminating tax levied against persons for selling goods brought into the State from other States or countries, it is difficult to conceive of a tax which would be discriminating." 116 U.S. at 454.

B. *Import-Export Clause*. Under the test established in *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 289 (1976), a state tax which falls on imports must be invalidated if, among other things, it usurps the exclusive federal authority to regulate foreign commerce or deprives the federal government of import revenues. The disparate tax treatment accorded in-state and foreign liquors creates, in practical effect, a preferential trade area for locally produced liquor. This is plainly inconsistent with the constitutional requirement that the nation speak "with one voice" in its commercial relations with foreign governments. Further, the high rate of the tax and its pyramid effect reduces the demand for foreign liquor which, in turn, decreases the volume of imports and the federal government's import revenues. The tax is, therefore, invalid under *Michelin* as an impost or duty prohibited by the Import-Export Clause.

C. *Equal Protection Clause*. The liquor tax denies the equal protection of the laws to out-of-state liquor manufacturers and wholesalers of out-of-state liquor by taxing liquor sales based solely on the origin of the liquor. *See Wheeling Steel Corp. v. Glander*, 337 U.S. 562, 571 (1948); *WHYY, Inc. v. Glassboro*, 393 U.S. 117, 119-20 (1968). Since the sole purpose of the classification is simple economic protectionism, the Equal Protection Clause must be applied "to give effect to its role to protect our federalism" by denying Hawaii "the power constitutionally to discriminate in favor of its own residents against the other state members of our federation." *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 533 (Brennan, J., concurring) (1959).

ARGUMENT

I. THE HAWAII LIQUOR TAX BY ITS TERMS, IN OPERATION, AND IN ACCORDANCE WITH EXPRESS LEGISLATIVE INTENT, DISCRIMINATES AGAINST INTERSTATE AND FOREIGN COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

The prohibition against state taxes which discriminate against interstate commerce has been a fundamental tenet of Commerce Clause doctrine from the beginning. The rule "follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977) (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951)).

The clear trend in the Court's recent decisions has been to permit the states broad discretion in forcing interstate commerce to "pay its own way."[13] The Court has, accordingly, shown increasing deference to state assertions that a questioned tax has a sufficient nexus with[14] or is fairly apportioned to[15] the taxing state. In distinct contrast to this trend, there has been no corresponding liberalization of Commerce Clause restrictions on discriminatory state taxation. In decisions covering more than 100 years of Commerce Clause analysis, this Court has

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[13] *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938). *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *Cf. Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976).

[14] *See, e.g., National Geographic Society v. State Board of Equalization*, 430 U.S. 551 (1977); *Standard Pressed Steel Co. v. Washington Revenue Department*, 419 U.S. 560 (1975); *United Air Lines, Inc. v. Mahin*, 410 U.S. 623 (1978).

[15] *See, e.g., Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Moorman Manufacturing Co. v. Blair*, 437 U.S. 267 (1978).

steadfastly adhered to the constitutional policy of free trade and competition among the states. The principle first articulated in *Welton v. Missouri*, 91 U.S. 275 (1876) remains true today: "No State may, consistent with the Commerce Clause, 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977) (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)). The reason is plain. Discriminatory state taxation creates, in practical effect, a tariff destructive of the free flow of commerce among the states.

Accordingly, any state tax which, by its terms or practical operation, imposes greater burdens on out-of-state goods or activities than on competing in-state goods or activities will be struck down as discriminatory under the Commerce Clause. Hawaii's liquor tax is such a discriminatory tax.

A. THE HAWAII LIQUOR TAX INTENTIONALLY EFFECTS DISCRIMINATION.

The legislative history of the liquor tax exemptions makes their purpose clear: To promote the development and growth of specified state liquor industries by providing five-year renewable tax exemptions which grant the favored local products a substantial cost advantage over out-of-state products. The purpose of the original 1960 exemption for okolehao was stated to be "to encourage and promote the establishment of a new industry."[16] When the exemption was reenacted in 1971, the legislature expressed the hope that "the taxes temporarily saved by [the okolehao manufacturers] may be channelled into national promotion and competitive pricing, the result of which is

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[16] S. Stand. Comm. Rep. Nos. 87 and 222, 1st Hawaii State Leg., Budget Sess. (1960), *reprinted in* 1960 Hawaii Sen. Journal 224, 256 (Appendices A and B). *See also* H. Stand. Comm. Rep. No. 322, 1st Hawaii State Leg., Budget Sess. (1960), *reprinted in* 1960 Hawaii House Journal 373 (Appendix C).

a linking of okolehao to Hawaii as tequila is to Mexico."[17] The 1976 extension of the okolehao exemption and the enactment of an additional exemption for the local wine industry was justified by the Hawaii Senate Ways and Means Committee as follows:

> The purpose of this bill is to extend the exemption of okolehao manufactured in the State from the liquor tax for an additional five years, to June 30, 1981. It is hoped that this five-year extension will aid the local okolehao industry [sic] get on a firm financial foundation.
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> Your Committee has amended this bill to provide a similar five-year exemption to the local fruit wine industry. Testimony received indicates that there may be an economic potential to the State in this area which, hopefully, this bill can help stimulate.[18]

The Conference Committee Report on the most recent exemption, for Hawaii-manufactured rum, evidences the Legislature's continued use of its tax system to benefit local manufacturers:

> The purpose of this bill is to exempt rum manufactured in the State from the liquor tax for five years. . . . Your Committee is aware of the consolidated cases in the State Tax Appeal Court, Civil Nos. 1852, 1862, 1866 and 1867, under the name *Bacchus Imports, Ltd., et al. v. Freitas,* currently pending in the State Supreme Court, regarding the validity of certain liquor tax exemptions, and has had extensive discussions with the Attorney General's Office and the State Tax Department regarding the cases. Your Committee also notes that opinions conflict as to whether or not the national tax structure provides an advantage to rum produced in Puerto Rico and therefore makes no findings on

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[17] H. Stand. Comm. Rep. No. 246, 6th Hawaii State Leg., Reg. Sess. (1971), *reprinted in* 1971 Hawaii House Journal 793-94 (Appendix D).

[18] S. Stand. Comm. Rep. No. 408-76, 8th Hawaii State Leg., Reg. Sess. (1976), *reprinted in* 1976 Hawaii Senate Journal 1056 (Appendix E). *See also* H. Stand. Comm. Rep. No. 689-76, 8th Hawaii State Leg., Reg. Sess. (1976), *reprinted in* 1976 Hawaii House Journal 1590 (Appendix F).

> that issue. *Your Committee does feel, however, that providing a tax incentive in the form of a liquor tax exemption for a period of years is an appropriate method of encouraging the development of a new industry in the State and is therefore in agreement with the intent of the bill.*[19]

Consistent with this history, the Hawaii Supreme Court found that the okolehao and wine exemptions were specifically intended to benefit local producers, concluding that "[n]o one could quarrel with the proposition that the promotion of domestic industry is a legitimate state purpose." *Matter of Bacchus Imports, Ltd.*, 656 P.2d at 730. While the court's comment might be relevant to an Equal Protection Clause analysis, it is well settled that discriminatory legislation cannot be justified under the Commerce Clause as a measure to assure the economic health of local industry. As Mr. Justice Blackmun stated in *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 43-44 (1980):

> In almost any Commerce Clause case it would be possible for a State to argue that it has an interest in bolstering local ownership, or wealth, or control of business enterprise. Yet these arguments are at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition.

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[19] S. Conf. Comm. Rep. No. 29, 11th Hawaii State Leg., Reg. Sess. (1981), *reprinted in* 1981 Hawaii Senate Journal 1056 (emphasis added) (Appendix H). *See also* H. Conf. Comm. Rep. No. 31, 11th Hawaii State Leg., Reg. Sess. (1981), *reprinted in* 1981 Hawaii House Journal 911-12 (Appendix G).

Indeed, such "simple economic protectionism" is subject to a "virtually *per se* rule of invalidity." *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).[20]

Where, as here, the state baldly announces its intent to confer a direct economic benefit upon local manufacturers by utilizing the liquor tax as a protective tariff against out-of-state products and justifies this policy on grounds repeatedly rejected by this Court, the tax is obviously repugnant to the Commerce Clause.

B. THE HAWAII LIQUOR TAX IS A CLASSIC EXAMPLE OF DISCRIMINATORY TAXATION.

The Hawaii Supreme Court held that "[t]he taxpayers have failed to demonstrate that the Hawaii Liquor Tax in its practical operation works discrimination against interstate commerce." *Matter of Bacchus Imports, Ltd.*, 656 P.2d at 735. This conclu-

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[20] *See Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) (New York statute excluding Vermont milk held invalid); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949) (New York required to permit state milk producer to export milk to other states, though price increases may result in New York). The *Baldwin* decision is particularly pertinent. After holding that the Commerce Clause prohibits obstructions to competition between the states, Mr. Justice Cardozo expressly rejected the proposition that such obstructions may be justified as measures to assure the economic health of local industry:

> If New York in order to promote the economic welfare of her farmers, may guard them against competition with the cheaper prices of Vermont, the door has been opened to rivalries and reprisals that were meant to be averted by subjecting commerce between the states to the power of the nation.
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> . . .
>
> The Constitution was framed under the dominion of a political philosophy less parochial in range. It was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.

294 U.S. at 522-23.

sion misreads this Court's recent Commerce Clause decisions[21] and ignores its earlier, and dispostitive, cases.[22] Indeed, one of the early cases, *Walling v. People of Michigan,* 116 U.S. 446 (1886), is identical in all material respects to the present case. In striking down the tax there at issue, the Court made an observation which is equally applicable here: "If this is not a discriminating tax levied against persons for selling goods brought into the State from other States or countries, it is difficult to conceive of a tax which would be discriminating." *Id.* at 454.

1. The Federal Precedents Compel The Invalidation Of The Hawaii Liquor Tax.

In a series of cases commencing with *Welton v. Missouri,* 91 U.S. 275 (1876) and ending with *I. M. Darnell & Son Co. v. Memphis,* 208 U.S. 113 (1908), this Court considered a number of state tax schemes similar to the Hawaii liquor tax. As in the present case, the state statutes at issue imposed taxes on merchants selling goods produced out-of-state, and exempted similarly situated merchants selling locally produced goods. In each case, this Court held that the taxes were discriminatory and invalidated them under the Commerce Clause.

In its *Welton* decision, the Court struck down as discriminatory a Missouri license tax which applied to peddlers of goods which were "the growth, product or manufacture of other States or countries," but did not apply to peddlers selling merchandise which was "the growth, product or manufacture" of Missouri. 91 U.S. at 275. The Court grounded its ruling on the necessity to prevent an economic Balkanization of the nation:

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[21] *Maryland v. Louisiana,* 451 U.S. 725 (1981); *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977); *Halliburton Oil Well Co. v. Reily,* 373 U.S. 64 (1963).

[22] *I. M. Darnell & Son Co. v. Memphis,* 208 U.S. 113 (1908); *Walling v. People of Michigan,* 116 U.S. 446 (1886); *Guy v. Baltimore,* 100 U.S. 434 (1880); *Welton v. Missouri,* 91 U.S. 275 (1876).

> The power of the State to exact a license tax of any amount being admitted, no authority would remain in the United States or in this court to control its action, however unreasonable or oppressive. Imposts operating as an absolute exclusion of the goods would be possible, and all the evils of discriminating state legislation, favorable to the interests of one State and injurious to the interests of other States and countries, which existed previous to the adoption of the Constitution, might follow, and the experience of the last fifteen years shows would follow, from the action of some of the States.

Id. at 281.

The Court reached the same conclusion a few years later in *Guy v. Baltimore*, 100 U.S. 434 (1880). There, the Court invalidated an ordinance of the City of Baltimore, authorized by a Maryland statute, which assessed wharfage fees against vessels which landed at the city's public wharves laden with the products of other states, but not against vessels landing there with the products of Maryland. Citing *Welton* and earlier decisions by the Court, Mr. Justice Harlan declared that "it must be regarded as settled that no State can, consistently with the Federal Constitution, impose upon the products of other States brought therein for sale or use, or upon citizens because engaged in the sale therein . . . of the products of other States, more onerous public burdens or taxes than it imposes upon the like products of its own territory." 100 U.S. at 439. To concede such power to the states "would render wholly nugatory all national control of commerce among the States, and place the trade and business of the country at the mercy of local regulations, having for their object to secure exclusive benefits to the citizens and products of particular States." *Id.* at 442.

The Court's next decision, *Walling v. People of Michigan*, 116 U.S. 446 (1886), deserves close scrutiny because it is, in all material respects, analogous to the present controversy. In that case, the State of Michigan imposed a tax on persons selling at wholesale, or soliciting orders for, liquor manufactured in other states, without imposing a like tax upon persons engaged in the

same business in reference to liquor manufactured in the state. Walling, a traveling wholesale salesman for an out-of-state manufacturer, challenged the validity of the tax. Mr. Justice Bradley, for a unanimous court, concluded that the violation of the Commerce Clause was beyond reasonable dispute:

> . . . [I]t is very difficult to find a plausible reason for holding that it [the tax] is not repugnant to the Constitution. It certainly does impose a tax or duty on persons who, not having their principal place of business within the State, engage in the business of selling, or of soliciting the sale of, certain described liquors, to be shipped into the State. *If this is not a discriminating tax levied against persons for selling goods brought into the State from other States or countries, it is difficult to conceive of a tax that would be discriminating*. It is clearly within the decision of *Welton v. Missouri* . . . .

116 U.S. at 454 (emphasis added).[23] McKesson, like Walling, is a wholesaler representing out-of-state manufacturers. It must pay tax on all of its sales whereas wholesalers representing the favored state manufacturers pay no tax. As in *Walling*, such differential taxation of liquor based on its origin is a "regulation in restraint of commerce among the States, and as such is a usurpation of the power conferred by the Constitution upon the Congress of the United States." 116 U.S. at 455.

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[23]In his opinion, Mr. Justice Bradley referred to state decisions acknowledging the states' lack of authority to prescribe regulations on articles in commerce based on their place of origin. His discussion of a decision of the Supreme Court of Missouri is particularly relevant to the issues in this case:

> In *State v. North*, 27 Mo. 464, where an Act of Missouri imposed a tax upon merchants for all goods purchased by them, except such as might be the growth, product or manufacture of that State, and manufactured articles the growth or product of other States, it was held by the Supreme Court of that State that the law was unconstitutional and void. The court says: "From the foregoing statement of the law and facts of this case it will be seen that it presents the question of the power of the States, in the exercise of the right of taxation, to discriminate between

I.M. Darnell & Son Co. v. Memphis, 208 U.S. 113 (1908), rounds out the Court's early decisions. The Darnell Company operated a mill in Tennessee purchasing logs from both within and without the state. The disputed personal property tax was assessed against Darnell's inventory of logs purchased from out-of-state sources, but, based on an exemption, not against logs procured in Tennessee. The tax was declared unconstitutional on the ground that it "was a direct burden on interstate commerce, since the law of Tennessee in terms discriminated against property the product of the soil of other states brought into the State of Tennessee, by exempting like property when produced from the soil of Tennessee." 208 U.S. at 126.

Welton, Guy, Darnell and particularly *Walling* are dispositive of the issues raised by this appeal. When Hawaii's legislature sought to encourage the development of its local liquor industry by enactment of taxing measures disadvantaging out-of-state manufacturers, it resurrected the precise taxing scheme condemned in each of these decisions. *Welton* and its progeny, therefore, compel the invalidation of Hawaii's liquor tax law.

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products of this State and those manufactured in our sister States." And after an examination of the causes which led to the adoption of the Federal Constitution, one of the principal of which was the necessity for the regulation of commerce and the laying of imposts and duties by a single government, the court says: "But, whatever may be the motive for the tax, whether revenue, restriction, retaliation or protection of domestic manufactures, it is equally a regulation of commerce, and in effect an exercise of the power of laying duties on imports; and its exercise by the States is entirely at war with the spirit of the Constitution, and would render vain and nugatory the power granted to Congress in relation to these subjects. Can any power more destructive to the union and harmony of the States be exercised than that of imposing discriminating taxes or duties on imports from other States? Whatever may be the motive for such taxes, they cannot fail to beget irritation and to lead to retaliation; and it is not difficult to foresee that an indulgence in such a course of legislation must inflame and produce a state of feeling that would seek its gratification in any measures regardless of the consequences."

116 U.S. at 457-58 (citations omitted).

While this Court's recent decisions have allowed the states greater leeway in exercising their taxing powers,[24] the Court plainly has not retreated from the antidiscrimination principle established in the *Welton* line of cases. Rather, the Court has continued to be zealous in setting aside any state tax which by its terms or in practical operation favors local over out-of-state interests. *Best & Co. v. Maxwell*, 311 U.S. 454 (1940). Indeed, the chief feature distinguishing the earlier from the more recent cases is that the state laws in question are usually more artfully drawn to disguise the discrimination.

The Court's decisions in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977) and *Maryland v. Louisiana*, 451 U.S. 725 (1981), are illustrative.

In *Boston Stock Exchange*, New York had amended its stock transfer tax so that the tax payable by nonresidents was reduced by 50% when the transaction involved an in-state sale, but not when it involved an out-of-state sale. Also, a maximum of $350.00 was applied to limit the tax on a single transaction (by either a resident or a nonresident) when the sale took place in-state, but not when it took place elsewhere. In his opinion for a unanimous Court, Mr. Justice White reiterated that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." 429 U.S. at 328. To permit "the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects." *Id.* at 329 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951)). Surveying the Court's decisions balancing the national interest in free trade with the interest of the states in exercising their taxing powers, Mr. Justice White noted:

> This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation." *Northwestern States Portland Cement Co. v.*

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[24] *See* cases cited *supra* notes 13 and 14.

> *Minnesota*, 358 U.S. 450, 457 (1959). Nevertheless, as observed by Mr. Justice Clark in the case just cited: "From the quagmire there emerge . . . some firm peaks of decision which remain unquestioned." *Id.* at 458. Among these is the fundamental principle that we find dispositive of the case now before us: No State may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Ibid.*

429 U.S. at 329. The transfer tax amendment was, accordingly, held unconstitutional. Because it "foreclose[d] tax-neutral decisions and create[d] both an advantage for the [stock] exchanges in New York and a discriminatory burden on commerce to its sister States," *Id.* at 331, the tax violated the principle that "in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Id.* at 337.[25]

Similarly, in *Maryland v. Louisiana*, 451 U.S. at 725, Louisiana imposed a tax on the "first-use" of natural gas brought into the state which had not previously been taxed by another state or by the United States. Through a series of exemptions and credits, Louisiana users of the natural gas were generally not burdened by the tax, while it uniformly applied to gas moving out of the state to consumers in the rest of the country. *Id.* at 732-33. The Court struck down the tax, holding that it "unquestionably discriminates against interstate commerce in favor of local interests." *Id.* at 756.

Maryland v. Louisiana and *Boston Stock Exchange* thus reaffirm the principle first established in *Welton, Guy, Walling*

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[25]*See also Halliburton Oil Well Co. v. Reily*, 373 U.S. 64 (1963), in which the Court considered a Louisiana use tax which was applied to an out-of-state taxpayer's labor and shop overhead costs associated with assembling specialized equipment that was brought into the state for use in the taxpayer's business. These costs would have been excluded from the tax base had the taxpayer assembled the equipment in Louisiana. Applying a "strict rule of equality," the Court set aside the tax as discriminatory against products assembled out-of-state. 373 U.S. at 73.

and *Darnell* that discriminatory state taxation is subversive of the most fundamental economic principles embodied in the Constitution. The Court has made no changes in doctrine or other departures from the earlier cases. A state tax which provides "a direct commercial advantage to local business" is *per se* invalid.[26]

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[26]State court decisions in other jurisdictions have consistently applied this principle and invalidated discriminatory taxes under the Commerce Clause. *See, e.g.*, *Archer Daniels Midland Co. v. State*, _______ Minn. _______, 315 N.W.2d 597 (1982); *Dayton Power & Light Co. v. Lindley*, 58 Ohio St. 2d 465, 391 N.E.2d 716 (1979); *American Trucking Associations, Inc. v. Quinn*, 437 A.2d 623 (Me. 1981); *American Modulars Corp. v. Lindley*, 54 Ohio St. 2d 273, 376 N.E.2d 575 (1978); *State, Dept. of Fisheries v. Dewatto Fish Co.*, 34 Wash. App. 135, 660 P.2d 298 (1983).

In *Archer Daniels Midland Co. v. State*, 315 N.W.2d 597, Minnesota's Supreme Court declared unconstitutional a portion of a statute which provided for a four-cent per gallon reduction in a gasoline excise tax for gasohol produced and distilled in Minnesota. The court held that the tax was *per se* invalid since it facially discriminated against out-of-state gasohol by placing a more onerous tax burden on such products simply because of their origin in another state. 315 N.W.2d at 599. The court also found the tax unconstitutional under the balancing test set forth in *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970). First, the tax statute did not regulate even-handedly. Second, the statute did not serve legitimate local interest such as public safety which may justify state regulation of interstate commerce. Rather, as in the present case, the statute attempted "to unfairly preserve local markets for local interests by conferring an artificial economic advantage to local interests under the state's taxing power." 315 N.W.2d at 599. The court concluded, therefore, that the statute "imposes a burden on interstate commerce which is clearly excessive in relation to the local benefit." *Id.*

In *American Trucking Associations, Inc. v. Quinn*, 437 A.2d 623, the Supreme Judicial Court of Maine struck down a truck tax which required owners and operators of foreign based trucks using state highways to purchase highway use permits, but which exempted entirely from tax gasoline-powered trucks based in state. The court found that the tax was invalid on its face because it discriminated against interstate commerce, since it set much higher permit fees for foreign-based trucks than for Maine-based ones. The court also noted the lower court finding that the statute was even more discriminatory in its practical effect than it appeared on its face, because it increased the average per-mile operating costs for

2. The Hawaii Supreme Court Failed To Follow The Federal Law.

Despite the patently discriminatory legislative purpose of the liquor tax and its inevitable practical effect, the Hawaii Supreme Court concluded that "[t]he taxpayers have failed to demonstrate that the Hawaii Liquor Tax . . . works discrimination against interstate commerce." *Matter of Bacchus Imports, Ltd.*, 656 P.2d at 735.

The lower court's fundamental error is that it failed to recognize that the Commerce Clause forbids precisely the sort of economic protectionism which the Hawaii liquor tax fosters. Indeed, as *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145-46 (1970) makes clear, the fact that the tax exemptions are intended "to preserve or secure employment for the home State," as they are here, is further proof of their unconstitutionality. A state may not use its power to tax or to regulate business " 'to divert to [itself] employment and business which might otherwise go' " elsewhere; " 'the necessary tendency' " of such enactments " 'is to impose an artificial rigidity on the economic pattern of the industry.' " *Id.* at 146 (quoting *Toomer v. Witsell*, 334 U.S. 385, 403-04 (1948)).[27]

Perhaps as a consequence of its misperception of the thrust of the Commerce Clause cases, the Hawaii Supreme Court

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foreign-based trucks 200 times more than it did for trucks registered in Maine. 437 A.2d at 626.

In *Dayton Power & Light Co. v. Lindley*, 391 N.E.2d 716, the Supreme Court of Ohio invalidated an Ohio coal consumption tax which imposed higher taxes on low sulphur coal than on high sulphur coal. Since Ohio produced predominantly high sulphur coal and very little low-sulphur coal the Court found that the practical effect of the tax was to encourage the purchase of Ohio high sulphur coal and discourage the purchase of out-of-state low sulphur coal. *See also Mapco, Inc. v. Grunder*, 470 F. Supp. 401 (N.D. Ohio 1979).

[27] *See also Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) and *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 523-24 (1935), discussed *supra* note 20 and accompanying text.

misread this Court's holdings in *Maryland v. Louisiana, Boston Stock Exchange* and *Halliburton.*

The former was distinguished by the lower court as follows: "Unlike the situation in *Maryland v. Louisiana, supra,* the incidence of the tax here is on wholesalers of liquor in Hawaii and the ultimate burden [of the tax] is borne by consumers in Hawaii." *Matter of Bacchus Imports, Ltd.,* 656 P.2d at 734. This ostensible distinction misses the point of the Commerce Clause cases. The discrimination created by the Hawaii tax scheme is directed against out-of-state products and the manufacturers of those products. Their products, solely by reason of their foreign origin, are subject to a significant tax burden whereas the products of domestic manufacturers are not. This is plainly the selfsame discrimination condemned in *Welton, Guy, Walling, Darnell* and *Halliburton.* That the ultimate tax burden fell on local consumers did not save the otherwise objectionable tax schemes. Indeed, Mr. Justice White specifically noted that "the statutes at issue in those cases [including, among others, *Welton* and *Halliburton*] had the primary effect of prohibiting or discriminatorily burdening a resident's purchase of out-of-state goods and services." *Boston Stock Exchange v. State Tax Commission,* 429 U.S. at 336.

That the liquor tax is paid by wholesalers in Hawaii is likewise no ground of distinction. A state tax is not immune from challenge simply because it is imposed on a local event or local entities at the end of interstate commerce. This point was made manifest in *Boston Stock Exchange:*

> Because of the discrimination inherent in § 270-a [the transfer tax], we also reject the Commission's argument that the tax should be sustained because it is imposed on a local event at the end of interstate commerce. While it is true that, absent an undue burden on interstate commerce, the Commerce Clause does not prohibit the States from taxing the transfer of property within the State, the tax may not discriminate between transactions on the basis of some interstate element. As was held in *Welton v. Missouri,* 91 U.S. 275, 282 (1876): "[T]he commercial power [of the Federal Government] continues until the commodity has

> ceased to be the subject of discriminating legislation by reason of its foreign character. That power protects it, even after it has entered the State, from any burdens imposed by reason of its foreign origin."

429 U.S. at 332 n.12 (citations omitted).[28] *See also I. M. Darnell & Son Co. v. Memphis*, 208 U.S. at 113 (where the incidence of the tax was clearly borne by local merchants and where, just as clearly, it made no difference in the outcome of the case).

The *Boston Stock Exchange* and *Halliburton* decisions, while discussed by the Hawaii Supreme Court, were quickly dismissed as factually inapposite. *Matter of Bacchus Imports, Ltd.*, 656 P.2d 734-35. While it is obvious that New York's transfer tax and Louisiana's use tax are factually dissimilar to Hawaii's liquor tax, the antidiscrimination principle articulated in those decisions is directly applicable to the constitutional question posed by Hawaii's law. Further, the lower court chose to ignore the cases most directly on point: *Welton, Guy, Walling* and *Darnell*. It commented merely that its "survey of the case law of Commerce Clause litigation in the Supreme Court has uncovered no instance where a state tax of similar nature has been voided." *Matter of Bacchus Imports, Ltd.*, 656 P.2d at 735.

In one further effort to distinguish the federal precedents, the Hawaii Supreme Court implied that the extent of the discriminatory impact of the Hawaii liquor tax is insubstantial and that the tax therefore does not violate the Commerce Clause. 656 P.2d at 735. To reach this conclusion the court "assume[d]" that okolehao and pineapple wine sold in Hawaii involve an insubstantial volume of commerce and thus "pose no competitive threat to other liquors produced elsewhere and consumed in Hawaii." *Id.* at 735 n. 21. It also noted its belief that these products are unique to Hawaii. *Id.* at 735 n. 20. Even assuming, for the sake of argument, that the Hawaii Supreme

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[28] *See also* Mr. Justice Harlan's discussion of this issue in *Guy v. Baltimore*, 100 U.S. at 443.

Court is correct in these assumptions,[29] they have no relevance to the question before this Court.

First, as early as *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419 (1827), the Court established that the constitutionality of a state tax does not turn on the extent of the alleged discrimination:

> It is obvious that the same power which imposes a light duty can impose a very heavy one, one which amounts to a prohibition. Questions of power do not depend on the degree to which it may be exercised. If it may be exercised at all, it must be exercised at the will of those in whose hands it is placed.

25 U.S. (12 Wheat.) at 439. More recently, in *Maryland v. Louisiana*, 451 U.S. at 725, this Court granted judgment on the pleadings to the taxpayers challenging the first use tax. In so ruling, the Court rejected the recommendations of its Special Master that further evidentiary hearings be conducted to determine the extent of the discrimination effected by the tax:

> It may be true that further hearings would be required to provide a precise determination of the extent of the discrimination in this case, but this is an insufficient reason for not now declaring the Tax unconstitutional and eliminating the discrimination. *We need not know how unequal the Tax is before concluding it unconstitutionally discriminates.*

451 U.S. at 759-60 (emphasis added). The inquiry, then, is not the degree of discrimination, but whether discrimination exists.

This rule is clearly salutary. Drawing the constitutional line between a valid and invalid state tax on the basis of the existence

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[29] Such assumptions would clearly *not* be appropriate for rum since it is a very popular liquor and is manufactured in many parts of the United States and the world. As noted earlier, locally manufactured rum was granted a tax exemption by the Hawaii legislature in 1981 and, accordingly, was being sold in the Hawaii market when this matter was heard by the Hawaii Supreme Court. Since rum was not manufactured in Hawaii when this action was begun (J.A. 16), any success the local industry now enjoys would appear to be directly traceable to its tax exempt status.

of a "competitive threat" measured by the volume of commerce actually affected is unsound. The constitutionality of a particular tax statute could fluctuate from year to year or even month to month depending upon changes in the marketplace or the fortunes of a particular business.[30] This is an unworkable standard for judicial review. The state's authority to tax would turn on an economic analysis of the cross-elasticity of demand in the relevant market. Proof would necessarily include volume of sales, market shares, pricing trends and the like. The outcome would be determined not by consistently applied constitutional principles, but by the vagaries of the economy.

Second, in determining whether discrimination exists, this Court has compared the actual tax burden on in-state and out-of-state goods or services with respect to a particular transaction.[31] As noted in *Halliburton Oil Well Co. v. Reily*, "equality [of tax treatment] for the purposes of competition and the flow of commerce is measured in dollars and cents, not legal abstractions." 373 U.S. at 70.

A dollars-and-cents comparison of the actual tax burden on in-state and out-of-state liquors shows that the Hawaii tax imposes a substantially greater burden on the latter. According to the Stipulation of Facts filed in the Hawaii Tax Appeal Court, a case of California wine priced at $10.00 a bottle (F.O.B. at the

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[30] For example, if the discriminatory effect of the okolehao exemption was measured in 1960, the year of its initial enactment, it is likely that no competitive effect would be found. If, however, the effect was determined in 1981, the last year of its several exemptions, the result might be considerably different.

[31] *See Boston Stock Exchange*, 429 U.S. at 334; *Maryland v. Louisiana*, 451 U.S. at 757 n. 28; *Memphis Steam Laundry v. Stone*, 342 U.S. 389 (1951); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940).

winery) would cost the Hawaii consumer $285.60.[32] The portion of this figure represented by the 20% Hawaii liquor tax is stipulated to be $56.40.[33] By contrast, a wholesaler selling wine manufactured in Hawaii is not subject to any liquor tax. Such a large tax penalty for selling out-of-state liquor cannot be deemed to have no practical effect on interstate commerce. *See Boston Stock Exchange*, 429 U.S. at 334.

A tax burden of $56.40 for a single case of wine is at least equal to the discriminatory burdens condemned in many of the Commerce Clause cases. For example, in *Memphis Steam Laundry v. Stone*, 342 U.S. 389 (1951), this Court found discriminatory a $50 license tax on each truck used by an out-of-state laundry business soliciting and picking up business in Mississippi because resident laundries were required to pay only $8 per truck. Similarly, in *Best & Co. v. Maxwell*, 311 U.S. 454 (1940), a discrepancy between the $1 annual tax paid by local merchants and the $250 annual tax paid by itinerant solicitors was found discriminatory. And in *Maryland v. Louisiana*, the Court used an example "to illustrate the possible discrimination" of the credit feature of the first use tax in which the tax differential was only $35. 451 U.S. at 757 n. 28. *See also Boston Stock Exchange*, 429 U.S. at 334.

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[32] Due to its *ad valorem* nature, the Hawaii liquor tax is assessed against every item of expense which is included in the cost of the wine to the consumer. These expenses include the producer's costs, freight, wharfage fees, drayage charges, warehousing charges, federal taxes, wholesaler's mark-up and, in the case of foreign wines, customs duties and brokerage fees. Stipulation of Facts ¶ 13. (J.A. 21-22). The Stipulation states that each increase of $1.00 in the producer's cost for a case of California wine (F.O.B. the winery) results in a price to the Hawaii consumer of $2.38. Stipulation of Facts ¶ 19. (J.A. 23). Hence a case of California wine with a F.O.B. price of $120.00 (12 bottles × $10.00 per bottle = $120.00) will cost $285.60 in Hawaii. ($120.00 × 2.38 = $285.60).

[33] Stipulation of Facts ¶ 19. (J.A. 23). The portion of the cost to the consumer attributable to the liquor tax is agreed to be $0.47 per $1.00 of F.O.B. price, which calculates to a tax of $56.40 on the case of wine posited in the example. ($120.00 × .47 = $56.40).

Thus, contrary to the belief of the Hawaii Supreme Court, the inequality of treatment accorded in-state and out-of-state products by Hawaii's liquor tax is discriminatory within the meaning of the Commerce Clause cases.

The obvious economic effect of such inequality of treatment is to encourage out-of-state business to relocate in Hawaii and to engender retaliatory taxes by other states.[34] The avoidance of a 20% tax on wholesale value is a strong incentive to relocate to Hawaii. Encouraging out-of-state business to relocate in-state by discriminating in favor of in-state transactions or goods produced in-state is violative of the Commerce Clause. In *Maryland v. Louisiana*, 451 U.S. at 725, for example, this Court found that an "obvious economic effect" of Louisiana's severance tax credit was to encourage outer continental shelf gas producers "to invest . . . within Louisiana rather than to invest in further OCS development or in production in other States." 451 U.S. at 756. This relocation incentive contributed to the Court's holding that the Louisiana tax unconstitutionally discriminated "against interstate commerce in favor of local interests," *Id.* at 756. Similarly, in *Boston Stock Exchange*, 429 U.S. at 318, the Court found that the "obvious effect" of the New York stock transfer tax was to "extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges." 429 U.S. at 331.

In addition to its relocation incentive, Hawaii's discriminatory liquor tax encourages retaliatory actions by other states. Indeed, the Hawaii legislation here at issue appears to be symptomatic of a trade war which is gaining momentum in the

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[34]The "practical operation" of a tax statute is to be assessed in terms of the statute's "actual and potential" discriminatory effect. *Nippert v. Richmond*, 327 U.S. 416, 424 n. 9 (1940) ("It is old doctrine, notwithstanding many early deviations, that the practical operation of the tax, *actual* or *potential*, rather than its descriptive label or former character is determinative.") (emphasis added and citations omitted). The Court has continued its scruntiny of potential effects by focusing on the "obvious economic effect" of a tax. *Maryland v. Louisiana*, 451 U.S. at 756-57; *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 331.

nation's liquor industry. At the present time, at least 20 states have adopted liquor tax statutes which discriminate in favor of locally produced liquor.[35] The recently enacted Maryland statute is typical: Wine produced by certain wineries from locally grown fruit is taxed at the rate of two cents per gallon, while out-of-state wine pays a tax of forty cents per gallon. Md. Ann. Code, art. 4, §§ 133(b)(1) and 133(g) (Supp. 1982). Moreover, the existence of these barriers to free trade has prompted a number of states to enact retaliatory taxes on liquors from states which discriminate against their products.[36] The prevention of such trade wars among the states is precisely the reason discriminatory taxation is strictly prohibited by the Commerce Clause.

[35]*See* Ark. Stat. Ann. §§ 48-402, 48-636, 48-711 (1977 & Supp. 1983); Fla. Stat. Ann. §§ 564.06, 565.12, 565.14 (West Supp. 1983); Ga. Code Ann. §§ 3-6-50, 3-4-60 (1982 & Supp. 1983); Ill. Ann. Stat. ch. 43, § 158-1 (Smith-Hurd Supp. 1983-84); Iowa Code Ann. §§ 123.136, 123.146 (West Supp. 1983-84); Ky. Rev. Stat. Ann. § 243.720 (Michie Supp. 1982); Me. Rev. Stat. Ann. tit. 28, §§ 452, 501 (Supp. 1982-83); Md. Ann. Code art. 4, §§ 5, 133 (1981 & Supp. 1982); Mich. Stat. Ann. § 18.987(1) (Callaghan Supp. 1983-84); Minn. Stat. Ann. § 340.436 (West Supp. 1983); Miss. Code Ann. § 27-71-7 (Supp. 1982); N. J. Stat. Ann. § 54:43-1 (West Supp. 1983-84); N.M. Stat. Ann. § 60-6A-11 (1981); N.C. Gen. Stat. §§ 105-113.86, 105-113.95 (1979 & Supp. 1981); R. I. Gen. Laws § 3-10-1 (Supp. 1982); S. C. Code Ann. § 12-21-1040 (Law. Co-op 1982); S.D. Codified Laws Ann. § 35-5-3.1 (1977); Tenn. Code Ann. §§ 57-3-207, 57-3-302 (1980); Tex. Alco. Bev. Code Ann. § 203.08 (Vernon 1978); Va. Code § 4-25.1 (1983).

[36]*See* Conn. Gen. Stat. Ann. § 12-451 (West 1983); Del. Code Ann. tit. 4, § 728 (1975); Ind. Code Ann. § 7.1-2-7-3 (Burns 1978); Mich. Stat. Ann. § 18.1011 (Callaghan Supp. 1983-84); Ohio Rev. Code Ann. §§ 4301.54, 4301.55 (Page 1982); Or. Rev. Stat. § 473.040 (1981); Pa. Stat. Ann. tit. 47, § 105 (Purdon 1969); and R. I. Gen. Laws §§ 3-10-15, 3-10-17 (1976).

II. THE HAWAII LIQUOR TAX IS AN IMPOST OR DUTY PROHIBITED BY THE IMPORT-EXPORT CLAUSE.

In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), this Court overturned a century of precedent in ruling that the Import-Export Clause does not prohibit a state from imposing a *nondiscriminatory* property tax on imported goods in their original carton.[37] In an opinion by Mr. Justice Brennan, the Court identified three principal concerns of the Framers underlying their adoption of a constitutional restraint on state taxation of imports:

> (1) The Federal Governmental must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power;
> (2) Import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and
> (3) Harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the inland States not situated as favorably geographically.

423 U.S. at 285-86 (footnotes omitted).

Applying this test, the Court upheld the application of Georgia's nondiscriminatory ad valorem property tax to Michelin's inventory of imported tires. It was "obvious" that such a tax could have "no impact whatsoever on the Federal Government's exclusive regulation of foreign commerce" because it did not "fall on imports as such because of their place of

[37] *See generally* Walter Hellerstein, "Constitutional Limitations On State Tax Exportation," 1982 Am. B. Foundation Research J. 1, 6-8, from which the following discussion of *Michelin* draws.

origin." 423 U.S. at 286. As a general tax applicable to all property in the state, it could not have been used "to create special protective tariffs or particular preferences for certain domestic goods," and could not be "applied selectively to encourage or discourage any importation in a manner inconsistent with federal regulation." *Id.* The Court likewise found that the imposition of a nondiscriminatory ad valorem property tax would not threaten the federal government's reliance upon imposts and duties as a source of revenue. Since a nondiscriminatory tax "cannot be selectively imposed and increased so as substantially to impair or prohibit importation," *id.* at 288, such a tax has at most an "incidental effect" on federal import revenues. *Id.* at 287. Finally, the Court found that the tax would not disturb the harmony among the states because the coastal jurisdictions would receive compensation only for services and protection extended to the imports by the local government. *Id.* at 289. *See Washington Revenue Department v. Washington Stevedoring Association*, 435 U.S. 734, 751-55 (1978).

In his analysis of the foreign policy and revenue issues, Mr. Justice Brennan made it clear that state taxation which falls on imports *must* be nondiscriminatory to pass muster under the Import-Export Clause. This is because such taxes create special protective tariffs which undermine the federal government's ability to speak "with one voice" and, by discouraging importation, decrease its revenues. To the point in this case, Mr. Justice Brennan's example of a prohibited discriminatory tax in footnote 7 of the *Michelin* opinion plainly embraces the tax here involved:

> Of course, discriminatory taxation in such circumstances is not inconceivable. For example, a State could pass a law which only taxed the retail sale of imported goods, while the retail sale of domestic goods was not taxed. *Such a tax, even though operating after an "initial sale" of the imports would, of course, be invalidated as a discriminatory imposition that was, in practical effect, an impost.* Nothing in the opinion of *Brown v. Maryland* should suggest otherwise. The Court in *Brown* merely pre-

sumed that at these later stages of commercial activity, state impositions would not be discriminatory. But merely because *Brown* would have authorized a nondiscriminatory charge on even an importer's use of the services of a public auctioneer, see 12 Wheat. at 443, 6 L.Ed. 678, does not mean that it would have disapproved the holding of *Cook v. Pennsylvania*, 7 Otto 566, 24 L.Ed. 1015 (1878), which invalidated a tax on the sale of goods by auction that discriminated against foreign goods.

Michelin Tire Corp. v. Wages, 423 U.S. at 288 n. 7 (emphasis added).

That Hawaii's liquor tax creates a preferential trade area for locally produced liquors antithetical to the federal government's exclusive control of foreign commerce is obvious. In operation, it is no less destructive of the government's import revenues. The rate of the tax has been repeatedly increased over the years to its present 20%.[38] This rate, plus the "pyramid" effect of the tax (particularly its assessment on top of federal customs duties), acts as a substantial deterrent to the importation of foreign liquors. For example, utilizing the data provided in the Stipulation of Facts, a case of French wine priced at $10 per bottle (F.O.B. the winery) would cost $387.60 by the time it reached the consumer in Hawaii. Fully $78 of this sum is liquor tax.[39] The cost of a case of Hawaii wine with an F.O.B. price of $10 per bottle would be $229.20, with no tax component. The difference in cost between the two cases of wine is $158.40,[40] nearly one-half of which is tax.[41] This price differential reduces the demand for foreign wines which, in turn, decreases the

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[38] *See supra* notes 7-11 and accompanying text.

[39] *See supra* notes 31-32 and accompanying text. The higher cost of the French wine is attributable to the greater distances involved in transporting the wine to Hawaii, federal customs brokerage fees, and the additional liquor tax assessed on each of these costs. Statement of Facts ¶¶ 13, 17-19. (J.A. 21-23).

[40] $387.60 (French wine)—$229.20 (Hawaii wine) = $158.40.

[41] $78.00 (tax applicable to French wine) ÷ 158.40 (cost difference) = 49%.

volume of imports and the federal government's import revenues.

Hawaii's liquor tax is also distinguished from the taxes imposed in *Michelin* and *Washington Revenue* by its rate. In *Michelin*, the personal property tax rate was only 1.2%; *Washington Revenue* involved a 1% business and occupation tax on stevedoring services. The tax challenged here is 20% of the wholesale value of the liquor sold. In view of this high rate, Hawaii's liquor tax has more than an "incidental" effect on the volume of foreign liquors imported into Hawaii. *See Michelin Tire Corp. v. Wages*, 423 U.S. at 286-88.

It is clear, then, that the Hawaii liquor tax does not satisfy the first two criteria of the *Michelin* test.[42] It is, therefore, invalid as an impost or duty prohibited by the Import-Export Clause.

III. THE HAWAII LIQUOR TAX VIOLATES THE EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT.

By limiting its tax exemptions to locally produced liquor, Hawaii fails to treat out-of-state manufacturers and the Hawaii wholesalers who represent their products in the same manner as it treats such businesses operating entirely in Hawaii. Once a state allows foreign corporations to do business within their borders, "the adopted corporations are entitled to equal protection with the state's own corporate progeny." *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, 571 (1949). In *Wheeling*, this Court declared unconstitutional a provision of Ohio's ad valorem property tax which subjected certain intangible property of non-Ohio corporations to a tax not applied to identical property of Ohio corporations. This Court concluded that the provision violated the Equal Protection Clause since the inequality of treatment was "not because of the slightest difference in Ohio's relation to the decisive transaction, but solely

[42] Since the tax does not apply to liquor whose ultimate sale or use is outside Hawaii, the third criteria in *Michelin* is not applicable.

because of the different residence of the owner." 337 U.S. at 572.[43] In *Allied Stores of Ohio v. Bowers*, 358 U.S. 522 (1959), this Court sustained a provision of Ohio's ad valorem property tax which exempted property held in storage warehouses by non-resident corporations, but did not exempt identical property of Ohio corporations.

In his concurring opinion in *Allied Stores*, Mr. Justice Brennan explained that the critical distinction between the Court's rulings in *Allied Stores* and *Wheeling* is rooted in our federal system:

> *Wheeling* applied the Equal Protection Clause to give effect to its role to protect our federalism by denying Ohio the power constitutionally to discriminate in favor of its own residents against the other state members of our federation.

358 U.S. at 533. In contrast, the tax at issue in *Allied Stores* discriminated in favor of non-residents and against the state's own residents. Such taxes do not disrupt the federal system. *Id.* The practical effect of the tax was to encourage interstate commerce. The discrimination thus did not invoke the protection of the Equal Protection Clause. In such cases, it is the choice of the particular state's legislature to balance the benefits gained in encouraging foreign corporations to do business in the state against the cost of taxing its own resident corporations.

But where the tax discriminates against non-residents in favor of residents of the taxing state, as in *Wheeling*, the practical effect of the tax is to discourage interstate commerce and to disrupt the federal system. 358 U.S. at 533. The Equal Protection Clause must then be applied as an "instrument of federalism" to eradicate the discrimination. *Id.* at 532.

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[43] *See also WHYY, Inc. v. Glassboro*, 393 U.S. 117, 119-20 (1968); *Concordia Fire Insurance Co. v. Illinois*, 292 U.S. 535, 545-47 (1934); *Hanover Fire Insurance Co. v. Carr*, 272 U.S. 494, 507-08 (1926); *Southern Railway Co. v. Greene*, 216 U.S. 400, 412, 417-18 (1910).

While Mr. Justice Brennan's view has not been adopted by a majority of this Court, *Western & Southern Life Insurance Co. v. Board of Equalization*, 451 U.S. 645, 667 n.21 (1981), the problems raised by the tax classification at issue here demonstrate the need to apply the principles of federalism embraced by the Clause. The tax was not enacted to further any valid state interests such as public health or safety. The sole purpose of the Hawaii tax is to favor the economic interests of resident liquor manufacturers and wholesalers who sell such liquor. Such simple economic protectionism must not be condoned as a legitimate state purpose under the Equal Protection Clause. *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). But rather, the Clause must be applied "to give effect to its role to protect our federalism" by denying Hawaii "the power constitutionally to discriminate in favor of its own residents against the residents of other members of our federation." *Allied Stores of Ohio v. Bowers*, 358 U.S. at 533 (Brennan, J. concurring).

CONCLUSION

For the reasons stated above, McKesson respectfully requests that the consolidated judgment of the Hawaii Supreme Court sustaining the validity of the Hawaii liquor tax be reversed, and the tax invalidated in its entirety. Accordingly, the taxes presently held in escrow should be returned or a credit applied against future tax liabilities in accordance with statutory requirements. Finally, the state should be enjoined against any future collection of the tax.

September 1, 1983

Respectfully submitted,

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APPENDIX

APPENDIX A

S. Stand. Comm. Rep. No. 87, 1st Hawaii State Leg., Budget Sess. (1960), *reprinted in* 1960 Hawaii Senate Journal 224.

The purpose of this bill is to exempt the firm of Ti Root Okolehao Hawaii, Inc. from the 16% alcohol tax in Section 124-4 of the Revised Laws of Hawaii 1955. The object of the bill is to encourage and promote the establishment of a new industry.

Your Committee on Ways and Means is in accord with the intent and purpose of Senate Bill No. 88 and recommends that it pass second reading and be re-referred to the Committee on Ways and Means.

Signed by all members of the Committee. Senator Yoshinaga did not concur.

APPENDIX B

S. Stand. Comm. Rep. No. 222, 1st Hawaii State Leg., Budget Sess. (1960), *reprinted in* 1960 Hawaii Senate Journal 256.

The purpose of this bill is to encourage and promote the establishment of the ti root okolehao industry.

Your Committee did not think it proper to give an exemption to one particular firm, and accordingly made the exemption applicable to all who are similarly situated.

The title was amended to read as follows:

"AN ACT TO AMEND SECTION 124-4, REVISED LAWS OF HAWAII 1955, AS AMENDED, TO EXEMPT TI ROOT OKOLEHAO DISTILLED IN THE STATE OF HAWAII, FROM THE 16% ALCOHOL TAX."

Section 1 was amended by deleting the phrase ". . . Ti Root Okolehao Hawaii Inc." and inserting in lieu thereof the phrase ". . . ti root okolehao distilled in the State of Hawaii."

Your Committee on Ways and Means is in accord with the intent and purpose of this bill and does therefore recommend that Senate Bill No. 88, as amended in S. D. 1. pass Third Reading.

Signed by all members of the Committee excepting Senators Yoshinaga and Ariyoshi.

APPENDIX C

H. Stand. Comm. Rep. No. 322, 1st Hawaii State Leg., Budget Sess. (1960), *reprinted in* 1960 Hawaii House Journal 373.

The purpose of this bill is to grant liquor tax exemption on the wholesale price of the liquor sold by the distillers of ti root okolehao in the State of Hawaii for a period of 5 years.

Your Committee is in accord with the intent and purpose of this bill and recommends its passage.

Signed by all members of the Committee. Representatives Kamaka, Kato, Kennedy and Milligan did not concur.

APPENDIX D

H. Stand. Comm. Rep. No. 246, 6th Hawaii State Leg., Reg. Sess. (1971), *reprinted in* 1971 Hawaii House Journal 793-94.

The purpose of this bill is to exempt okolehao manufactured in Hawaii from the state liquor tax law for a period of five years.

Section 244-4 imposes a twenty percent excise tax upon the wholesale price of liquor in respect of the transaction by which the seller, user or his vendor acquired the same. Exceptions thereto are enumerated, including, inter alia, liquor held for sale by a permittee but not yet sold or sold between permittees, liquor sold or used for sacramental or prescription purposes, or liquor neither delivered or to be used in the state or which is otherwise constitutionally exempt.

Enactment of this bill would add to the list of exemptions, okolehao manufactured in Hawaii for a period of five years. The department of taxation is opposed to any type of exemption without "strong justification." Your Committee has considered the arguments advanced in favor of the exemption and finds them sufficiently strong.

Testimonies were received that over the past decade well over a million dollars has been lost attempting to create a significant market for ti root okolehao, fabled in song and legend as Hawaii's own spirit product. Once before, in fact, the industry similarly requested, and the legislature granted, a five year period of exemption which has since expired.

According to the Distilled Spirits Institute, Hawaii now realizes over $9 million from the twenty percent tax annually. However, according to the state department of taxation, since expiration of the previous exemption several years ago, only a very small share (less than 1.0%) of this sum is attributable to sales of various liquors manufactured locally (only a part of which is okolehao, for which the exemption is sought).

It is hoped by industry that the taxes temporarily saved by this relatively new and expanding business may be channeled into national promotion and competitive pricing, the result of which is a linking of okolehao to Hawaii as tequila is to Mexico. Even with the anticipated expanded sales, it is expected that the total annual tax otherwise due on okolehao sales would amount to less than $15,000 per year. Relief is not sought from the general excise tax.

Considering the jobs this industry creates and the prospects presented by proper promotion of its product, your Committee believes that the tax revenue loss is nominal only compared with the benefit, particularly when reviewed in light of the thousands of dollars appropriated annually by the state in matching funds to promote other products grown and manufactured in Hawaii. Thus, the benefit to this industry (and the state) is by parity if not in kind.

Your Committee respectfully recommends the changes which it has effected to the amendment: (1) correct spelling of the word "okolehao," (2) substitute the word "manufacture" for the word "made," and delete the words "of Hawaii" following the word "State."

Your Committee on Finance is in accord with the intent and purpose of H. B. No. 588, as amended herein, and recommends that it pass second reading in the form attached hereto as H. B. No. 588, H. D. 1, and be placed on the calendar for third reading.

Signed by all members of the Committee.

APPENDIX E

S. Stand. Comm. Rep. No. 408-76, 8th Hawaii State Leg., Reg. Sess. (1976), *reprinted in* 1976 Hawaii Senate Journal 1056.

The purpose of this bill is to extend the exemption of okolehao manufactured in the State from the liquor tax for an additional five years, to June 30, 1981. It is hoped that this five-year extension will aid the local okolehao industry get on a firm financial foundation.

Your Committee has amended this bill to provide a similar five-year exemption to the local fruit wine industry. Testimony received indicates that there may be an economic potential to the State in this area which, hopefully, this bill can help stimulate.

Your Committee on Ways and Means is in accord with the intent and purpose of S.B. No. 2230-76, as amended herein, and recommends that it pass Second Reading in the form attached hereto as S.B. No. 2230-76, S.D. 1, and be placed on the calendar for Third Reading.

Signed by all members of the Committee.

APPENDIX F

H. Stand. Comm. Rep. No. 689-76, 8th Hawaii State Leg., Reg. Sess. (1976), *reprinted in* 1976 Hawaii House Journal 1590.

The purpose of this bill is to grant liquor tax exemption [sic] for five years to the local okolehao industry and local fruit wine industry.

The exemption to the okolehao industry is an extension of a present exemption for another five years. The exemption granted to the fruit wine industry is new. The intent is to stimulate these industries and help to place them on a firm financial foundation.

Your Committee on Finance is in accord with the intent and purpose of S.B. No. 2230-76, S.D. 1, and recommends that it pass Second Reading and be placed on the calendar for Third Reading.

Signed by all members of the Committee except Representative Amaral.

APPENDIX G

H. Conf. Comm. Rep. No. 31, 11th Hawaii State Leg., Reg. Sess. (1981), *reprinted in* 1981 Hawaii House Journal 911-12.

The purpose of this bill is to exempt rum manufactured in the State from the liquor tax for five years and to delete the prohibition on labeling or selling rum as "Hawaii Rum" or "Hawaiian Rum" unless it has been aged for at least two years. The bill also provides that liquor may be labeled or sold using the word "Hawaii," "Hawaiian," or "Aloha State" as long as it is at least partially manufactured in the State.

Under present law, it is required that rum be aged for at least two years from the date of distillation if it is to be labeled or sold as "Hawaii Rum" or "Hawaiian Rum." Your Committee notes that the labeling prohibition has proved to be an effective bar to local distillers establishing a market for Hawaiian rum.

Your Committee feels that the labeling requirement bears no reasonable relationship to insuring the quality of the product and therefore agrees with the intent of the bill that there is no need for such an aging requirement prior to labeling.

Your Committee is aware of the consolidated cases in the State Tax Appeal Court, Civil Nos. 1852, 1862, 1866 and 1867, under the name *Bacchus Imports, Ltd., et al. v. Freitas,* currently pending in the State Supreme Court, regarding the validity of certain liquor tax exemptions, and has had extensive discussions with the Attorney General's Office and the State Tax Department regarding the cases. Your Committee also notes that opinions conflict as to whether or not the national tax structure provides an advantage to rum produced in Puerto Rico and therefore makes no finding on that issue. Your Committee does feel, however, that providing a tax incentive in the form of a liquor tax exemption for a period of years is an appropriate method of encouraging the development of a new industry in the State and is therefore in agreement with the intent of the bill.

Your Committee has made a technical correction to the bill.

Your Committee on Conference is in accord with the intent and purpose of H.B. No. 247, S.D. 2, as amended herein, and recommends that it pass Final Reading in the form attached hereto as H.B. No. 247, S.D. 2, C.D. 1.

Representatives Blair, Andrews, Baker, Hirono and Liu,
Managers on the part of the House.

Senators Yamasaki, Abercrombie and Henderson,
Managers on the part of the Senate.

APPENDIX H

S. Conf. Comm. Rep. No. 29, 11th Hawaii State Leg., Reg. Sess. (1981), ***reprinted in*** **1981 Hawaii Senate Journal 917.**

The purpose of this bill is to exempt rum manufactured in the State from the liquor tax for five years and to delete the prohibition on labeling or selling rum as "Hawaii Rum" or "Hawaiian Rum" unless it has been aged for at least two years. The bill also provides that liquor may be labeled or sold using the word "Hawaii," "Hawaiian," or "Aloha State" as long as it is at least partially manufactured in the State.

Under present law, it is required that rum be aged for at least two years from the date of distillation if it is to be labeled or sold as "Hawaii Rum" or "Hawaiian Rum." Your Committee notes that the labeling prohibition has proved to be an effective bar to local distillers establishing a market for Hawaiian rum.

Your Committee feels that the labeling requirement bears no reasonable relationship to insuring the quality of the product and therefore agrees with the intent of the bill that there is no need for such an aging requirement prior to labeling.

Your Committee is aware of the consolidated cases in the State Tax Appeal Court, Civil Nos. 1852, 1862, 1866 and 1867, under the name *Bacchus Imports, Ltd., et al. v. Freitas,* currently pending in the State Supreme Court, regarding the validity of certain liquor tax exemptions, and has had extensive discussions with the Attorney General's Office and the State Tax Department regarding the cases. Your Committee also notes that opinions conflict as to whether or not the national tax structure provides an advantage to rum produced in Puerto Rico and therefore makes no finding on that issue. Your Committee does feel, however, that providing a tax incentive in the form of a liquor tax exemption for a period of years is an appropriate method of encouraging the development of a new industry in the State and is therefore in agreement with the intent of the bill.

Your Committee has made a technical correction to the bill.

Your Committee on Conference is in accord with the intent and purpose of H.B. No. 247, S.D. 2, as amended herein, and recommends that it pass Final Reading in the form attached hereto as H.B. No. 247, S.D. 2, C.D. 1.

Senators Yamasaki, Abercrombie and Henderson,
Managers on the part of the Senate

Representatives Blair, Andrews, Baker, Hirono and Liu,
Managers on the part of the House